BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

BOB STUMP, Chairman
GARY PIERCE
BRENDA BURNS
BOB BURNS
SUSAN BITTER SMITH

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR A HEARING TO DETERMINE THE FAIR VALUE OF THE UTILITY PROPERTY OF THE COMPANY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, TO APPROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN.	Docket No. E-01345A-11-0224

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ANSWERING BRIEF OF

THE ARIZONA INVESTMENT COUNCIL

September 12, 2014

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The Arizona Investment Council ("AIC") submits its Answering Brief in response to Staff's Initial Post-Hearing Brief, RUCO's Closing Brief, Sierra Club's Post-Hearing Brief and the Initial Brief of the Arizona School Boards Association and Arizona Association of School Business Officials.[1]

I. INTRODUCTION

Not unexpectedly, the Opening Briefs of Staff and RUCO indicate no change from the rate of return recommendations they offered in filed testimony. Staff maintains the rate of return of 6.09% mentioned in Section 5.3 of the Settlement Agreement should be used. That results in a revenue deficiency of slightly more than $57 million—roughly $13 million less than the $70 million non-fuel-related revenue requirement estimated by the parties, explained by Staff and anticipated by the Commission to result from this proceeding when the rate order was issued.[2] RUCO's recent debt issuance cost assertion is about $21 million less than the parties and Commission's expectations when the Settlement Agreement was executed and approved. Only Arizona Public Service Company's ("APS" or the "Company") WACC approach of $65.43 million is consistent with, although somewhat less than, the parties and Commission's anticipated $70 million increase.

The Commission should conclude the Four Corners acquisition was prudent (a finding supported by all parties except the Sierra Club) and enter its Order authorizing a rate adjustment of $65.43 million. As Mr. Yaquinto testified:

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[1] Because AIC has taken no position on the issue of whether and how to apply the Four Corners Rate Rider to AG-1 customers, AIC will not respond to the Joint Initial Closing Brief of the AG-1 Intervenors.

[2] Decision No. 73183, p. 25, ll. 1-4.

> [T]hese assets should be included in rate base as if they were part of [the] original rate case. This means the same weighted cost of capital for Units 4 and 5 should be used as was applied in the rate case for the Company's total original cost rate base.[3]

This result is the only position which satisfies the Rate Case Order and Settling Parties' twin objectives of rate stability together with rate gradualism as discussed in AIC's Opening Brief.

The Commission should deny Sierra Club requests to reject the Company's Units 4 and 5 rate base requests; condition future approvals of adjustments on vaguely defined "revised and robust" analyses; and put APS on notice concerning rate basing of a shortfall obligation.

Finally, the Commission should reject the Arizona School Boards Association and Arizona Association of School Business Officials' (collectively, "ASBA/AASBO") newly proffered and legally incorrect position that the Commission is constitutionally barred from approving a rate increase in this proceeding.

II. ARGUMENT

A. The Commission should reject Sierra Club objections to the Four Corners transaction.

In its Post-Hearing Brief, the Sierra Club continues its endless litany of objections to the Acquisition. No doubt sensing its imprudence position is failing to gain traction, Sierra Club refocuses on its complaints about (I) natural gas price assumptions, (II) allegedly incomplete capital expenditure projections and (III) unrealistic carbon price trajectories. Where coal-fired resources are concerned, one certainly can conclude that the Sierra Club never met such a plant that it liked.

[3] AIC-2, p. 6, ll. 12-14.

No matter how firmly held its beliefs, however, the Sierra Club objections can't overcome the weight of the evidence offered by APS and Staff that the Four Corners transaction is prudent and provides substantial benefits. For example, Staff witness James Letzelter concluded that the additional 179 MW of capacity are used and useful; an appropriate range of resource options was considered; APS' economic analysis of the transaction was sound; the economics of it favor APS customers; its timing was prudent; any risks are offset by favorable economics; several ancillary benefits also add to the transaction's positive impacts on customers; and the Four Corners transaction is prudent.[4] Consistent with that Staff assessment, on rejoinder, APS Resource Planning Director James Wilde stated:

> Dr. Hausman's assertion [for Sierra Club] that APS has withheld information regarding the data and calculations used to conduct the net present ("NPV") analysis of the Four Corners transaction is wholly without merit....Staff concurs with the result of these analyses, and no other intervenor has questioned that the transaction has a substantial positive economic benefit for APS customers.
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> APS has been forthright and transparent regarding the natural gas and carbon prices used in its analysis. APS has provided the data and methodologies employed and substantiated its conclusion that the Four Corners transaction is prudent and in the best interest of APS customers.[5]

At pages 6-10 of its Post-Hearing Brief, Staff elaborates as to the six different findings supporting the fact that the Four Corners transaction is in the public interest and was prudent. They range from the capacity provided by Four Corners is necessary through the transaction is economically sound.[6] Sierra Club's objections, to the contrary, are simply without merit.

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[4] S-1, Letzelter Direct, p. 3, ll. 1-9.
[5] APS-13, p. 1, ll. 19-24 and p. 4, l. 26–p. 5, l. 3.
[6] Staff Initial Post-Hearing Brief, pp. 6-10.

B. RUCO relies on the wrong decision in attempting to justify its cost-of-debt based $49.2 million recommended increase.

Relying on language from the Four Corners Acquisition Order, RUCO attempts to justify its 4.75% cost of debt rate of return position by reference to language in Decision No. 73130—the decision which authorized APS to move forward with the Acquisition. That argument is flawed for several reasons.

First, the controlling decision here is not the Acquisition Order. Instead, it is the Rate Case Order. In that regard, Decision No. 73183 was held open for the express purpose of allowing APS to "reflect in rates the rate base and expense effects" associated with the Acquisition. As Mr. Yaquinto testified, RUCO's debt issuance cost position would preclude the Company from recovering the rate base and expense effects of the transaction—the precise reason the parties, including RUCO, agreed to and the Commission approved holding open the rate case record for the limited purpose of making this adjustment.

Second, confirming the unreasonableness of RUCO's argument here is the fact that the settling parties—RUCO among them—estimated and the Commission anticipated in holding the record open that the rate adjustment result would be approximately $70 million. RUCO's $49 million cost of debt position undercuts that mark by $21 million or roughly 30%.

Finally, RUCO attempts to justify its rate of return stance by citing language from the Acquisition Order that APS' "goal...in the way it manages the acquisition of Four Corners was "to minimize the rate impact to its customers."[7] There are three problems with that assertion.

First, rate impact minimization was the charge of the Acquisition Order, not the Rate Case Decision which is the controlling Order here. Second, APS' WACC position does, in fact,

[7] RUCO Closing Brief, p. 2, ll. 20-21.

minimize rate impact. The APS request is roughly $4.5 million less than what the Commission and parties anticipated would be the result from this proceeding. Further, the parties and Commissioners expected a 3% increase to the average residential bill. APS' proposal cuts that to 2.33%. Third, and most importantly, RUCO's position also ignores Staff witness Letzelter's analysis that the transaction was "reasonable and prudent, and calculated to provide [rate] benefits to APS customers."[8] Among others, Mr. Letzelter's rate assessments supporting those conclusions are:

> The economics of the transaction are favorable to APS customers...the timing of the transaction was prudent...and several ancillary benefits add to the positive impact that the transaction will have for customers.[9]

RUCO argues that its rate of return position—simply because it is the lowest rate result offered—is closest to the Commission's stated goal.[10] To the contrary, it varies the most from achieving the stated purpose of this proceeding, i.e., to allow APS to reflect in rates the "rate base and expense" effects of the transaction. Selecting, as RUCO does, the return rate on one debt transaction in the Company's capital portfolio clearly does not come remotely close to complying with that goal.

C. Staff's reliance on the Settlement Agreement's FVROR is incorrect and inconsistent with the express terms of the Settlement Agreement.

In its Initial Post-Hearing Brief, as indicated, Staff agrees that the Acquisition is in the public interest and is economically beneficial to the Company and its ratepayers. Staff's lone disagreement with APS concerns the correct rate of return. Instead of using the Company's weighted average cost of capital of 8.33%, Staff maintains that the 6.09% fair value rate of return

[8] S-1, Conclusions at p. 16 of Final Report.
[9] *Id.*
[10] RUCO Closing Brief, p. 3, ll. 1-2.

mentioned by the parties in Section V of the Settlement Agreement should be used. Use of that return number, however, will not allow APS to realize the result intended by the parties and approved by the Commission in the Rate Case Order, i.e., to "(1) minimize the earnings erosion that would otherwise result from the stay out, (2) support its earnings profile in the interim and (3) avoid negative earnings and ratings impacts for both investors and customers."[11] As importantly, Staff's Fair Value Rate of Return assertion is directly at odds with the provisions of the Settlement Agreement which control this case.

On January 6, 2012, Staff filed the detailed, comprehensive 22-page Settlement Agreement in this case. Its Section 5.3 stated a "fair value rate of return of 6.09%...shall be adopted" in the rate case. Relying on that provision which was used in the main case, Staff's position here is that the appropriate rate of return for this Acquisition proceeding should be the same 6.09%. Staff's position, however, directly conflicts with the Settlement Agreement for two reasons.

First, the parameters for this Four Corners Acquisition are specified in a separate section of the Settlement Agreement, i.e., Section X, not Section V upon which Staff relies. Section 10.2 directs that in this proceeding APS will be allowed to reflect in its rates "the rate base and expense" effects of the transaction. There is no mention of nor reference to Section 5.3's 6.09%. Had either Staff or the other Settling Parties in crafting the Agreement, or for that matter the Commission in approving it, intended to use that 6.09% rate in this proceeding, they could have—but did not—specify it.

Second, and most importantly, Section 10.4 of the Settlement Agreement expressly prohibits Staff's reliance in this proceeding on Section 5.3:

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[11] Yaquinto Direct, AIC-1, p. 5, ll. 6-9 (emphasis supplied).

> The signatories shall not raise any issues in the rate adjustment proceeding other than those specifically described in Section 10.2. (Emphasis supplied.)

Notably, the parties made no reference in Section 10.2 to Staff's return rate position stated in Section 5.3. In contrast, APS' use of the 8.33% WACC does allow it to rate base appropriately and consistent with standard Commission practice the effects of the transaction as APS, Staff, RUCO, AIC and the rest of the Settling Parties expressly agreed.

D. The Commission should reject the objections belatedly advanced by ASBA/AASBO in their Initial Brief.

ASBA/AASBO's Initial Brief asserts the Commission is constitutionally prohibited from approving the Four Corners Rate Rider. As explained below, this argument lacks legal merit. However, as an initial matter, ASBA/AASBO waited more than two years to challenge the Commission's authority and, therefore, its objection may be barred by the doctrine of laches.

ASBA/AASBO have been parties to this docket since October 2011.[12] They were among the 27 parties who participated in the rate case settlement meetings.[13] As intervenors and settlement discussion participants, they were aware of the provisions of the Settlement Agreement. Specifically, they knew the agreement included this "hold open" provision as well as the expectation that the Four Corners transaction could result in a rate increase as early as July 2013.[14] They were also aware that this hold open provision was a key factor in APS' consent to the Settlement Agreement, particularly its rate case moratorium provision.[15]

[12] October 25, 2011 Procedural Order granting intervention.
[13] Staff February 29, 2012 Opening Brief at 7.
[14] Sections 10.2 and 10.3, p. 15, Settlement Agreement approved in Decision No. 73183; Staff February 29, 2012 Opening Brief at 31-32.
[15] Decision No. 73183 at 25.

Despite this knowledge, ASBA/AASBO took no position and filed no testimony opposing the Settlement Agreement or alerting the Commission to any alleged constitutional infirmities.[16] Instead, they waited more than two years to raise any objection (constitutional or otherwise). During this period of silence, the members of ASBA/AASBO have enjoyed the benefit of the zero increase to base rates approved by the Decision. Given ASBA/AASBO's unreasonable delay in objecting as well as the resultant prejudice to APS, the doctrine of laches may be applicable to bar their arguments at this late date. *See Sotomayor v. Burns*, 199 Ariz. 81, 13 P.3d 1198 (2000).

ASBA/AASBO present two arguments. First, they assert APS' rate rider is unconstitutional because the rate case used a 2010 historic test year, but the proposed rate adjustment will be based on a post-test year acquisition. According to ASBA/AASBO, this temporal discrepancy violates the constitutional requirement that the Commission set rates based on fair value at the time of inquiry. This argument fails for several reasons.

First, Arizona law is clear that the Commission has discretion to consider matters subsequent to the historic test year. *Ariz. Corp. Comm'n v. Ariz. Public Serv. Co.*, 113 Ariz. 368, 371, 555 P.2d 326, 329 (1976). There is nothing unconstitutional in the time difference between the test year and rate rider data. Second, the argument ignores the fact that the proposed rider is an "adjustment" to rates, which, by definition, is intended to change the rates based on additional, post-test year events and information. Taken to its logical conclusion, ASBA/AASBO's theory would render all adjustor mechanisms unconstitutional. However, we know from experience—as well as the case law cited in the ASBA/AASBO brief—that adjustors are permissible under appropriate circumstances. *Scates v. Ariz. Corp. Comm'n*, 118 Ariz. 531,

[16] Decision No. 73183 at p. 4, n.3 and p. 9, n.35.

578 P.2d 612 (App. 1978). Finally, ASBA/AASBO's argument incorrectly assumes the valuation and costs associated with the Four Corners transaction are all new information. To the contrary, at the time of the initial rate case decision, the record before the Commission included extensive information regarding the costs and rate impacts of the Four Corners transaction.[17] The primary difference between the information presented to the Commission "at the time of inquiry" and now is that APS proposes a Four Corners' rider which is 67 basis points lower than what the Commission anticipated. ASBA/AASBO's argument regarding the timing of the rate rider should be rejected.

Their second argument is approval of APS' rate rider will amount to single-issue ratemaking prohibited by the Arizona Court of Appeals decision in *Scates*. To the contrary, not only does APS' rider comply with *Scates*, it also meets the requirements of two other Arizona cases which address the constitutional parameters of the Commission's authority to make and adjust rates.

First, in *Ariz. Corp. Comm'n v. Ariz. Pub. Serv. Co.*, 113 Ariz. 368, 555 P.2d 326 (1976), the Arizona Supreme Court considered whether use of a historic test year resulted in confiscatory rates. In approving use of a historic test year, the Court nonetheless expressed concern that the Commission was operating under an overly narrow interpretation of its constitutional authority. The Court clarified that the Commission had constitutional discretion to consider post-test year events and that doing so was consistent with the public interests of (1) promoting rate stability and (2) minimizing the need for a "constant series of rate hearings." *Id.* at 371, 555 P.2d at 329.

Two years later, the Arizona Court of Appeals addressed a Commission order that approved a partial rate increase, outside of a rate case, without any analysis of the company's

[17] *See* Docket No. E-01345A-10-0474; Decision No. 73183 at pp. 25-26.

financial condition or the impact on the utility's rate of return. *Scates*, 118 Ariz. at 533, 578 P.2d at 614. There, the Court held the Commission lacked authority to grant the increase under those circumstances. However, the Court acknowledged that a rate increase may be permissible based on limited or updated rate case data:

> We do not decide in this case, for example, whether the Commission could have referred to previous submissions with some updating or whether it could have accepted summary financial information.

Id. at 537, 578 P.2d at 618.

The following year, the Arizona Supreme Court had another opportunity to consider the Commission's discretion to adjust rates based on post-test year events. *Ariz. Cmty. Action Ass'n v. Ariz. Corp. Comm'n*, 123 Ariz. 228, 599 P.2d 184 (1979) involved the Commission's approval of a rate formula that would allow the utility's rates to automatically increase in the following year if the company's return on common stock equity fell below a certain threshold. The Court held that the Commission could not authorize such an increase based solely on return on common stock, because that particular criterion was (1) a factor over which the utility exercised total control and (2) completely divorced from the interests of the consumer. *Id.* at 231, 599 P.2d at 187. None of those factors are present here.

Taken together, these three Arizona appellate court decisions establish the parameters governing the Commission's authority to approve and confirm its ability to address APS' proposed rate rider here. Consistent with the Supreme Court's 1976 APS decision, approval of this Four Corners' rider promotes rate stability and minimizes the need for a constant series of rate hearings. Further, APS' proposal does not present the kind of single-issue ratemaking concerns raised in *Scates* and *Ariz. Cmty. Action Ass'n*. The data provided by APS and covered in the hearing is precisely the kind of information the *Scates* Court indicated the Commission

should consider in connection with a rate adjustment request. The filing also allows the Commission to conduct the kind of balanced analysis—weighing the interests of the company and the consumer—that the Court endorsed in *Ariz. Cmty. Action Ass'n.*

The Commission should reject ASBA/AASBO's constitutional attack. The Commission's decision approving the Settlement Agreement, including its provisions to hold open the rate case for the limited purpose of adjusting rates based on the Four Corners transaction, complies with all relevant constitutional requirements. By requiring APS to submit updated financial information as well as analyses of the proposed increase on both the utility and its customers, the Commission ensured that it would have sufficient information upon which to enter a fair and reasonable rate adjustment. None of the arguments belatedly offered by ASBA/AASBO change the constitutionality of the initial rate decision or the Commission's discretion to adjust those rates in this phase of that proceeding.

III. CONCLUSION

The parties agreed and the Commission approved holding open this rate case record for the appropriately bounded, constitutionally authorized purpose of approving a rate adjustment for the benefit of customers and the Company alike. It satisfies the twin objectives of rate fairness and gradualism. The record fully supports APS' request for a rate rider of $65.44 million. The AIC urges the Commission to approve it.

RESPECTFULLY SUBMITTED this 12th day of September, 2014.

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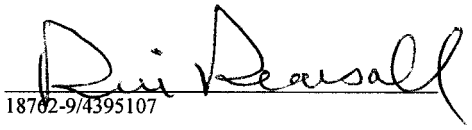

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